

GAO

Report to the Chairman, Committee on  
Government Operations, House of  
Representatives

March 1993

# PENSION PLANS

## Labor Should Not Ignore Some Small Plans That Report Violations



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United States  
General Accounting Office  
Washington, D.C. 20548

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Human Resources Division

B-251274

March 26, 1993

The Honorable John Conyers, Jr.  
Chairman, Committee on Government  
Operations  
House of Representatives

Dear Mr. Chairman:

In May 1991, we reported on fund abuses in pension plans for which the Pension Benefit Guaranty Corporation (PBGC) had assumed responsibility.<sup>1</sup> Our report stated that information in PBGC's files indicated that the Department of Labor may not have acted on data about apparent violations concerning asset use, and the Internal Revenue Service (IRS) may not have acted on data about funding deficiencies, both shown in annual reports filed by pension plans. Specifically, our PBGC review disclosed that reports for 14 pension plans, filed during the late 1970s through the mid-1980s, had shown that the employers failed to make required contributions (11 plans), that funds had been used for prohibited purposes (5 plans), or both.

Because PBGC's files were incomplete regarding these agencies' actions, you asked us to follow up and determine (1) whether the agencies had identified and acted on the information and (2) what the agencies' current procedures and practices are for dealing with apparent violations.

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## Results in Brief

Labor had not identified nor taken any enforcement action on the apparent prohibited uses of funds shown in reports filed by the five pension plans, and there is no assurance that Labor will act on similar violations in the future. As part of a new enforcement targeting system, Labor has developed programs that can identify plans that report prohibited fund uses. However, the programs are designed to screen out certain small plans because Labor's policy is to focus on larger plans. Most plans that our PBGC review identified as having engaged in prohibited fund uses would not have been identified by Labor's targeting programs. We believe, and Labor has agreed, that it should stop screening out certain small plans.

IRS's data showed that for 9 of the 11 plans that our PBGC review had identified, either the sponsors had corrected the funding deficiencies or IRS had identified the deficiencies and taken appropriate actions. The agency,

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<sup>1</sup>Pension Plans: Fiduciary Violations in Terminated Underfunded Plans (GAO/HRD-91-87, May 13, 1991).

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however, had no record of receiving required reports from the other 2 plans. IRS's current procedures provide reasonable assurance that the agency acts on funding deficiencies reported by pension plans.

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## Background

The Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA) to protect the benefits of participants in private pension plans. The act is administered by PBGC, Labor's Pension and Welfare Benefits Administration (PWBA), and IRS.

ERISA establishes various requirements for administering defined benefit pension plans.<sup>2</sup> For example, to help ensure that plans have sufficient funds, employers are required to make annual contributions to the plans. Failure to make the contributions subjects employers to an excise tax. In addition, to help ensure that plan assets are safeguarded, ERISA generally (1) provides that plan administrators, trustees, investment managers, and other fiduciaries use plan assets solely for the benefit of participants and (2) lists specific asset transactions that are prohibited, such as loans to the employers sponsoring the plans.

ERISA also requires plans to file periodic financial reports showing how assets are being used, including whether prohibited transactions have occurred. Plans meet this requirement by filing annual reports in the form 5500 series, Annual Return/Report of Employee Benefit Plan. The plans file the reports at one of IRS's service centers, where reports are screened for errors and entered onto computer tapes, which are then shared with PWBA.

PWBA is primarily responsible for oversight of the fiduciary and reporting requirements. IRS is responsible for ensuring that plans comply with the funding requirements.

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## Scope and Methodology

Our PBGC review disclosed that 14 defined benefit pension plans that it had taken over had reported (1) the employers' failure to make required contributions, (2) that funds had been used for prohibited purposes, or (3) both. We asked PWBA and IRS about the actions they had taken on this information.

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<sup>2</sup>PBGC insures defined benefit pension plans, which provide for a specific retirement benefit that is generally based on a worker's years of service, earnings, or both. If a plan terminates with insufficient funds to pay for the benefits earned by its participants, PBGC takes over the plan and administers it.

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We also obtained information on PWBA's and IRS's current procedures for processing form 5500 reports and for dealing with information in the reports indicating possible ERISA violations. We reviewed and tested PWBA's procedures for identifying prohibited fund uses by 188 defined benefit pension plans that had indicated such fund uses on their form 5500 reports for plan year 1988. Similarly, we reviewed and tested IRS's procedures for identifying funding deficiencies reported by 582 defined benefit pension plans with plan year 1988 form 5500 reports. We selected 1988 because PWBA tested the targeting programs that focus on prohibited fund uses on 1988 form 5500 reports. In addition, as part of our test, we reviewed a judgmental sample of case files of completed plan year 1988 investigations at each agency to determine the reasonableness of the conclusions reached.

Our review was performed between May 1991 and November 1992 in accordance with generally accepted government auditing standards.

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### **Labor May Not Identify Violations Reported by Some Small Plans**

PWBA did not take any enforcement action on the apparent prohibited uses of funds shown in reports filed by five defined benefit pension plans in the late 1970s to early 1980s identified in our PBGC review. Because of past deficiencies, PWBA's data base for form 5500 reports was not reliable and therefore was not used to select plans for review at the time the five plans filed their reports.

In recent years, PWBA has taken steps to correct its data base problems. In addition, the agency has developed computerized targeting programs for use by its field offices in selecting plans for review from this data base. The targeting programs, however, automatically exclude some small plans from identification because PWBA's policy is to focus on larger plans.

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### **PWBA Did Not Act on Reported Violations in the Past**

Our previous review at PBGC identified five defined benefit pension plans that had used funds for prohibited purposes. Four plans had loaned funds to their sponsors, and the fifth had used plan funds to help purchase a building for the sponsoring business. Three of the plans had reported the loans on their form 5500 reports; the other two plans had provided financial data indicative of the loans or building purchase, such as interest receivable or real estate and mortgage holdings. The form 5500 reports for the five plans were filed in the late 1970s through the mid-1980s.

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PWBA officials said their enforcement data base did not show any action on the form 5500 reports filed by the five plans that had reported data indicative of prohibited fund use. The officials explained that before plan year 1988, PWBA's data base of form 5500 reports had many data entry, as well as other, errors. As a result, the agency's field offices viewed the data base as an unreliable indicator of potential violations; the offices, therefore, did not use it as a basis for selecting plans for review. Consequently, PWBA had not identified nor acted on these plans' reports.

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### **PWBA's New Processes Identify Reported Violations Except by Certain Small Plans**

To make the form 5500 reports useful for selecting plans for review, PWBA, beginning with filings for plan year 1988, arranged with IRS to (1) improve the quality of data reported on the form 5500 reports and (2) help ensure that accurate information is entered into the data base. PWBA also developed computerized programs for its area offices to use in selecting plans for review from the improved data base. Some of these programs target data items on the form 5500 reports that indicate prohibited uses of plan funds. PWBA's field offices tested these programs during fiscal year 1991 with plan year 1988 form 5500 filings. The programs identified plans that reported prohibited uses of funds, a PWBA official said, but there were problems with the data.

Our review corroborated the official's conclusion regarding both the programs' success and the data problems. We found that the programs had properly identified plans responding that prohibited fund uses had occurred. Our review also showed, however, that in most cases the data were incorrect. In these cases, the plans had either erroneously (1) responded "yes" instead of "no" to questions that, in effect, asked whether the plan had engaged in prohibited uses of funds or (2) reported as violations certain financial transactions or conditions that are permitted by ERISA. In the latter instances, the plans apparently did not clearly understand ERISA requirements. Through its inquiry, PWBA apprised plan officials of the errors, which should help them to prepare accurate reports in the future. In about 15 percent of the 188 plans, PWBA found either prohibited fund uses or indications of possible violations that needed further review.

PWBA field offices generally have wide discretion in selecting pension plans for review and the targeting programs provide them one means to do so. However, these programs will not provide a complete basis for selecting plans because the programs are designed to exclude small plans that have less than a threshold number of participants and asset value. Four of the

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plans that our PBGC review showed had engaged in prohibited fund uses would have been screened out by the threshold. Moreover, one of the plans had reported less than the threshold value of assets because it had excluded, from the financial data on the form 5500 reports, the assets involved in the prohibited loans.

PWBA's exclusion of small plans from being identified by the targeting programs is inconsistent with the results of its enforcement activities. PWBA's enforcement data show that most reviews of small plans made in fiscal years 1986-89 identified ERISA violations, while most reviews of larger plans did not. For example, in fiscal year 1989, the most recent year analyzed by PWBA, about 65 percent of reviews of plans with fewer than 26 participants found ERISA violations; about 35 percent of the reviews of plans with 100 to 999 participants, however, found violations. In addition, the small plan cases resulted in recouping an average of about \$75,000 of prohibited fund uses per case reviewed, while the larger plan cases averaged about \$50,000 per case.<sup>3</sup> PWBA's data showed that in 1989 most manual or computer reviews of data from form 5500 reports for plans with under 26 participants identified ERISA violations.

The agency's enforcement policy is to protect the largest number of plan participants and plan assets, PWBA officials said, with the relatively limited resources PWBA has available; thus, the targeting programs were designed to screen out certain small plans. In addition, the threshold only screens out about 10 percent of the small plan participants; these plans are covered in other ways by PWBA's enforcement activities. For example, some oversight of such small plans is provided by reviews of service providers and inquiries into complaints received from plan participants. PWBA's enforcement data confirm that complaints regarding small plans are a productive source for finding violations. In 1989, 70 percent of the complaint cases that concerned plans with under 26 participants identified ERISA violations.

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## IRS Procedures Identify Violations and Require Action

Our PBGC review identified 11 defined benefit pension plans that had reported not receiving required contributions from their sponsors during the late 1970s through the mid-1980s. A search of the IRS data base showed filing and enforcement data for 9 of the plans, IRS officials said, but showed no data on receiving form 5500 reports for the other 2. Our review of IRS's enforcement data for the 9 plans showed that either the sponsors had

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<sup>3</sup>The dollar amounts of violations were higher in the large plan cases. However, because violations were found more often in the small plans, the average recoupment for these plans was higher.

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made the contributions and paid the excise taxes or IRS had identified the funding deficiencies and taken appropriate actions on them. We could not determine from PBGC's data whether the 2 plans had submitted the reports to IRS.

Our test of IRS's current procedures related to plans' reports of funding deficiencies showed that the agency's targeting system identified such plans. Plans reporting funding deficiencies in excess of a certain amount usually were automatically referred to IRS field offices for examination, while plans with smaller deficiencies were reported to the field offices for follow-up at their discretion. In about 6 percent of the 582 cases in our test, IRS's data showed that it either had not identified the funding deficiency or had no record of the plan. Many factors could have caused these results, IRS officials said, such as changes in the plans' identification numbers or errors made in filing the reports.

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## Conclusions

IRS's procedures generally are effective in identifying pension plans, including small plans, that report funding deficiencies and provide reasonable assurance that appropriate actions will be taken. In contrast, while Labor has developed the capability to identify plans that report prohibited fund uses, Labor's procedures ignore some small plans. Labor's enforcement data, however, show that violations are more prevalent among such plans. We believe that it is inappropriate to exclude from identification plans with less than the threshold number of participants and asset value since (1) this information is an indication of apparent ERISA violations and (2) our PBGC review found that such plans had engaged in prohibited fund uses. Since Labor's policy is to allow its field offices discretion in deciding which plans to review, we believe that the field offices should consider data on all plans reporting prohibited fund uses, not just those above the threshold.

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## Recommendation

We recommend that the Secretary of Labor direct the Assistant Secretary for Pension and Welfare Benefits to eliminate the automatic exclusion of certain small plans by the targeting programs that address prohibited fund uses.

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## Agency Comments

PWBA commented on a draft of this report, stating that the computerized targeting programs' parameters would be changed to eliminate any restrictions related to plan size. PWBA noted that with the change, its field



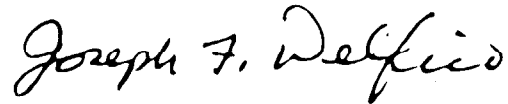
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offices will have available information on all plans for use in selecting plans for investigation. The agency's comments also included a discussion of PWBA's ERISA enforcement strategy and how the strategy addresses small plans. (See app. I.)

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As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report for 30 days. At that time, we will send copies to interested congressional committees, the Secretary of Labor, the Acting Commissioner of the Internal Revenue Service, and other interested parties, and will make copies available to others on request. If you have any questions concerning this report, please call me on (202) 512-7215. Other major contributors are listed in appendix II.

Sincerely yours,



Joseph F. Delfico  
Director, Income Security Issues

# Comments From the Pension and Welfare Benefits Administration

**U.S. Department of Labor**

Pension and Welfare Benefits Administration  
Washington, D.C. 20210



July 18 1993

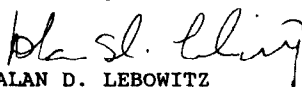
Mr. Lawrence H. Thompson  
Assistant Comptroller General  
Human Resources Division  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Thompson:

In reply to a request for comments on the draft GAO report entitled "Pension Plans: Labor Should Not Ignore Some Small Plans that Report Violations," the Department's response is enclosed.

The Department appreciates the opportunity to comment on this report.

Sincerely,

  
ALAN D. LEBOWITZ  
Deputy Assistant Secretary

Enclosure

**Appendix I  
Comments From the Pension and Welfare  
Benefits Administration**

Enclosure

U.S. DEPARTMENT OF LABOR'S RESPONSE TO THE  
DRAFT GENERAL ACCOUNTING OFFICE REPORT ENTITLED  
"PENSION PLANS: LABOR SHOULD NOT IGNORE  
SOME SMALL PLANS THAT REPORT VIOLATIONS"  
GAO DRAFT REPORT NO. GAO/HRD-93-45

**GAO RECOMMENDATION**

"We recommend that the Secretary of Labor direct the Assistant Secretary for Pension and Welfare Benefits to eliminate the automatic exclusion of certain small plans by the targeting programs that address prohibited fund uses."

**RESPONSE**

The Pension and Welfare Benefits Administration's computer targeting system provides information from the Form 5500 annual reports filed by employee benefit plans to assist in enforcement case selection by field offices. In view of the recommendation in this report, we will change the parameters of the computerized targeting to eliminate any restrictions related to the size of plans. Thus, the field offices will have available, for use in selecting plans for investigation, information on all small employee benefits plans without participant or asset size limitations.

**Discussion**

The draft report is correct in noting that the current computerized targeting system limits the parameters for selection of the Form 5500 annual reports of smaller employee benefit plans for computer analysis based upon plan size in terms of dollars of plan assets and number of participants. The universe of employee benefit plans that file Form 5500 annual reports with the Federal government includes 135,000 filers of plans with more than 100 participants which account for approximately 96 percent of all participants and 85 percent of plan assets in private employee benefit plans. There are 702,000 filers of annual reports of plans with fewer than 100 participants which account for 4 percent of all participants and 15 percent of dollars in private employee benefit plans. (These figures are based upon plans filing reports for plan year 1989.)

You should also be aware that the annual report information is part of a combined filing designed by and available to the Department, the Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation. The Department's statutory enforcement responsibilities are directed toward the conduct of employee benefit plan fiduciaries and service providers of

**Appendix I  
Comments From the Pension and Welfare  
Benefits Administration**

employee benefit plans including transactions that are prohibited by ERISA. Under the ERISA framework, the IRS also has enforcement responsibilities to correct prohibited transactions. The Department's enforcement remedy is limited to seeking a correction of the violation in a civil action in federal district court since it does not have an administrative mechanism to achieve this result absent voluntary correction by the affected party. Where there has been no demonstrable financial harm to the plan, there is little that the court will do other than correct the transaction. Under such circumstances, the only effective enforcement course of action is for the Department to refer the violation to the IRS.

The IRS can seek the correction of the prohibited transaction and can administratively impose a penalty in the form of an excise tax. The IRS penalty applies whether or not there has been any disadvantage to the plan from the prohibited transaction. Thus, the IRS is often in the best position to take enforcement action by obtaining correction of the prohibited transaction and, more importantly, by the administrative imposition of the excise tax.

The Department's enforcement policy is carried out pursuant to an enforcement strategy that seeks to maximize enforcement resources in relation to the large number of employee benefit plans and fiduciaries and service providers to those plans. The Department has focused its enforcement strategy toward designated significant issues. In terms of smaller plans, an important component of the significant issues strategy is the concentration of resources on investigations of abusive practices by service providers and financial institutions. One service provider or financial institutions may provide services to a large number of employee benefit plans. An enforcement action or correction involving such entities multiplies its affect on all of the plans serviced by the service provider or financial institution, including many small plans. PWBA's enforcement activities include investigations of all plan sizes and types; the widest impact on smaller plans is though the effect of the significant issues approach.

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# Major Contributors to This Report

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